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OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
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MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

From: Trade Policy Review Group

Subject: Brazilian Informatics Section 301

ISSUE

On May 14, 1986, the EPC informally agreed that the Brazilian informatics restrictions represent an "unreasonable" trading practice under section 301 and directed the TPRG to begin preparing a retaliatory package. The EPC further agreed that it would recommend that the President make a formal finding of unreasonableness under section 301, unless Brazilians entered into "serious negotiations" to resolve the informatics dispute. The EPC must now review the results of the bilateral consultations with the Brazilians and determine an appropriate USG response in preparation for USTR's September 15 recommendation to the President and Brazilian President Sarney's September 10 visit.

BACKGROUND

Section 301 Case

- o This informatics case is one of three that were self-initiated by the Administration last September. USTR must provide a recommendation to the President on September 15. The President then has 21 days (until October 6) to review the recommendation.

Brazilian Informatics Policy

- o The informatics investigation challenges a Brazilian law and policies that severely restrict U.S. trade and investment in the informatics sector and withhold explicit copyright protection for computer software.
- o These policies have resulted in a rapid and unchecked proliferation of restrictions on U.S. informatics products. A comparative market analysis prepared by the U.S. Department of Commerce and approved by an inter-agency working group estimates that U.S. companies are losing between \$337 and \$452 million in sales of hardware and software per year as a result of the Brazilian restrictions.

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EPC Decision

- o In February, the GOB agreed to meet with the USG in Caracas. The talks were polite, but unproductive.
- o On May 14, the EPC informally agreed that the Brazilian informatics regime is a violation of section 301 and directed the TPRG to develop a package of retaliatory options. The EPC further agreed to recommend that the President issue a formal finding of unreasonableness, unless the Brazilians entered into "serious negotiations" within a "reasonable period of time."
- o Informatics is a highly nationalistic issue in Brazil and the section 301 case is often perceived as an attack on Brazilian national sovereignty. Reports of the EPC's decision led to a series of inflammatory newspaper articles in Brazil and a negative public reaction.
- o On May 26, Deputy Secretary of State Whitehead visited Brasilia. The Whitehead visit succeeded in calming the Brazilians and produced an agreement to begin bilateral consultations. (The Brazilians had previously refused to negotiate.)
- o On July 2, USTR Yeutter and Brazilian Special Ambassador Paulo Tarso Flecha da Lima held bilateral consultations in Paris. Although the GOB delegation was cordial, it made no concessions. However, the Brazilians indicated that the Sarney Administration has "no present intention" of applying the market reserve policy to other sectors, such as pharmaceuticals, or extending the policy as it relates to trade after its scheduled expiration date in 1992. Apart from these clarifications, the Brazilians firmly defended the informatics law.
- o The third round of consultations on August 11 focussed on a non-paper listing USG objectives in the section 301 case. The Brazilians were polite but showed very little flexibility. They indicated that the GOB is weighing possible forms of intellectual property protection for computer software and offered to communicate the results of their internal deliberations to the USG. They also offered to establish an ad hoc government appeals group to review problems encountered by U.S. companies on a case-by-case basis.
- o On August 12, Ambassador Yeutter delivered a letter to Ambassador Paulo Tarso which outlined objectives in the areas of market reserve, administrative procedures, investment and intellectual property rights. On September 3, the GOB submitted its written response, which largely reiterated

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concessions already discussed during the two previous rounds of consultations. Certain proposals were actually weakened in the written version. Most of the concessions were vaguely-worded commitments for future action. As in the Paris talks, the most prominent omission was in the investment area.

- o Although the GOB's response is the first written commitment the USG has received, we do not know whether it represents Brazil's "final offer." However, Ambassador Paulo Tarso indicated to Ambassador Schlaudemann that the GOB was prepared to continue talks after President Sarney's visit.

Progress of Negotiations

Our assessment of Brazil's offer is as follows:

- o Market Reserve - The production of informatics products is limited to Brazilian national companies through a policy known as "market reserve." The effect of market reserve is to prohibit foreign trade and investment in certain segments of the Brazilian market. The USG has asked for a commitment not to renew market reserve for informatics after 1992, a phase-out of market reserve for certain informatics products, and an agreed definition of "informatics" products to limit the vague and expansive interpretation by SEI.

Status: The Brazilians' letter indicated that the Sarney Administration has no intention of renewing market reserve for informatics after it expires in 1992 or of extending market reserve to new sectors. They have clarified, however, that Sarney is not in a position to bind future Brazilian presidents or the Brazilian Congress. In addition, even without "formal" market reserve, Brazil uses other trade and investment measures to restrict its market. The Brazilians have also indicated that their all-encompassing interpretation of "informatics" products, e.g. toy animals containing a computer chip, is deliberate and fully consistent with the spirit of the law. The GOB's written response indicates there is a "possibility" of providing the USG with a list of products excluded from the definition of "informatics." However, this list would be updated each year, significantly diminishing the list's usefulness in establishing certainty for U.S. industry.

- o Investment - Brazil restricts new U.S. investment in the informatics sector and limits the expansion, upgrading, and modernization of existing production facilities. The USG has asked for national treatment for U.S. firms, a right to upgrade existing facilities without government interference, and implementation of provisions of the informatics law

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allowing 30 percent foreign ownership of joint ventures and 100 percent foreign ownership in exceptional circumstances. The U.S. would also like to see some limits on Brazilian export performance and local content requirements.

Status: The Brazilians deny that U.S. firms face investment restrictions and have offered no assurances that they will permit even the limited joint ventures provided for in the law. Nor is there a provision for the termination of market reserve as it relates to investment. Moreover, it is not clear from the Brazilians' letter whether the new CONIN appeals process applies to investment, as well as import, decisions; nor is it apparent how SEI's modernization will assist the investment approval process.

- o Administrative Procedures - U.S. companies have complained about burdensome and opaque Brazilian administrative procedures. The USG has asked for time limits, clear criteria for evaluating applications, and a right of appeal.

Status: The GOB's letter proposes (1) CONIN as an appeals board for companies contesting SEI decisions; (2) "modernization" of SEI's administrative procedures; (3) establishment of ad hoc committees within the U.S.-Brazil Trade Subgroup "to survey special issues of concern to our bilateral economic relationship;" and (4) adoption of "indicative" schedules for decisions related to imports and investments. While some of these proposals appear to be responsive to Ambassador Yeutter's requests, the proposals contained in the letter are not sufficiently detailed to allow an assessment. The GOB response did not offer to provide definitive criteria for SEI's approval of import licenses nor to specify time limits for reviewing applications.

- o Computer Software - The USG is seeking full copyright protection for computer software, i.e. life of the author plus 50 years, as well as a commitment by the GOB to refrain from a proposed decree that would require the registration of all imported software and restrict the importation of any software with a Brazilian national "similar."

Status: The GOB informed us that CONIN has recommended that copyright be adopted for software. We know from President Sarney's recent discussion with Ambassador Schlaudemann that the GOB believes 25 years' protection would be sufficient, although this detail is omitted from its letter. We have no assurance that the Congress will approve the President's legislation once submitted. Absent from the letter are responses to our request to

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(1) review the draft software intellectual property rights protection proposal before it is submitted to the Brazilian legislature; (2) improve enforcement of intellectual property rights, including trade secret protection; and (3) not extend market reserve to software.

U.S. Industry

- o The U.S. industry has taken a cautious approach to the case, since several companies have major investments in Brazil which could be the targets of counter-retaliation. Consequently, the case has been driven by the USG's concerns about the implications of Brazilian policies for future bilateral trade relations and the spread of market reserve to other sectors in Brazil as well as to other developing countries.
- o Some in the industry have indicated that the USG should proceed with retaliation if necessary, since abandoning the case now could encourage further proliferation of restrictions on U.S. products in Brazil and other developing countries. Others, however, expressed a strong preference for avoiding retaliation, since a trade war could jeopardize their investments.
- o When approached on a possible interim deal, the industry was adamant that computer software receive full (life plus 50 years) copyright protection. Industry representatives stated that the companies would support an interim package that included copyright protection, no software registration requirements, a list of excluded products, and GATT notification.

Congressional Views

- o In general, Congress has not played an active role in the development and pursuit of this section 301 case. Because of the U.S. informatics industry's ambivalence about the case, there has been no pressure for Members to become active participants in the issue.
- o However, should Brazil refuse to grant further concessions and should we refrain from retaliating, we should expect serious opposition from those in Congress who believe that the Administration lacks resolve in trade policy and section 301 in general. Those who wish to eliminate Presidential discretion in section 301 and other statutes may use our unwillingness to take strong action against Brazil as a argument to press for amendments limiting the President's discretion. In addition, those who seek retaliation against Brazil for constituent reasons, e.g. representatives of

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footwear-producing states, will criticize the lack of action.

Brazilian Debt

- o Brazil is unlikely to undertake broad, precipitous action with respect to its debt service (i.e. a moratorium) but its level of rhetoric is likely to increase, even though this could hurt Brazil by undermining financial market confidence. The GOB may also continue to refuse to eliminate \$2 billion in arrears of official credit, including \$300 million to Eximbank.

GATT Implications

- o Since the beginning of the section 301 case, there has been inter-agency agreement that the informatics issue should not be pursued in GATT. First, several important elements of the case, such as investment and intellectual property, are not subject to current GATT disciplines. Second, it is doubtful that Brazil would cooperate in a GATT dispute settlement proceeding and even more unlikely that Brazil would accept an adverse panel ruling.
- o Nevertheless, several elements of the informatics policy raise serious GATT questions, such as the market reserve and law of similars. These issues were raised briefly in Brazil's 1985 GATT Balance-of-Payments (BOP) Committee review. Brazil, however, took an unhelpful approach to the BOP review. Brazil may receive support for its restrictions from other developing countries who also use BOP measures to restrict imports and protect domestic industries.

Recommendations

1. That the USTR recommend that the President find Brazil's policy to promote a national informatics industry unreasonable within the meaning of section 301 of the Trade Act of 1974. To date, the Brazilian Government has not offered a satisfactory settlement of this case;
2. that the President not make a decision regarding unreasonableness until October 6, pending the results of the ongoing bilateral negotiations;
3. in light of the possibility of achieving further gains through negotiation, that the USTR defer specific recommendations as to appropriate actions in order to pursue such negotiations. The USTR will advise the President of the outcome of these negotiations before October 6 (the statutorily-required date for Presidential determination) and recommend an appropriate course of action at that time.

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